

## Message Text

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13-12

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C O N F I D E N T I A L CARACAS 1372

EXDIS

E.O. 11652 - XGDS-1

TAGS: ENRG, PFOR, VE

SUBJECT: THE PETROLEUM SCENE

1. SUMMARY: THE MINES MINISTER TOLD ME THAT SHELL AND MOBIL HAVE NOW JOINED EXXON IN SIGNING OFFTAKE AND TECHNICAL ASSISTANCE CONTRACTS. HE SEEMS CONFIDENT THAT HIS STRATEGY OF HOLDING FIRM ON THE PRICES AND WAITING OUT THE COMPANIES IS BRINGING SUCCESS. THE MINISTER ASSURED ME THAT THE COMPANIES WILL BE ABLE TO RETRIEVE THEIR CASH FROM THE GUARANTY FUND AS PROMISED BUT WAS LESS FORTHCOMING ON THE TAX PROBLEM ARISING FROM UNAMORTIZED COSTS ASSOCIATED WITH RELINQUISHED CONCESSIONS. HE SAID THE GOV WILL SOON ANNOUNCE A PILOT PROGRAM FOR THE DEVELOPMENT OF THE ORINOCO PETROLIFEROUS BELT. END SUMMARY.

2. I CALLED FEBRUARY 4 ON MINISTER OF MINES AND HYDROCARBONS VALENTIN HERNANDEZ AT MY REQUEST FOR A REVIEW OF THE POST-NATIONALIZATION SITUATION AND A DISCUSSION OF COMPANY PROBLEMS.

3. THE MINISTER SAID THAT OFFTAKE AND TECHNICAL ASSISTANCE CONTRACTS HAVE NOW BEEN SIGNED WITH MOBIL AND SHELL, AS WELL AS WITH EXXON. (COMMENT: THIS WAS NEWS TO ME. WE WERE TOLD BY A COMPANY SOURCE AS LATE AS YESTERDAY THAT THE SHELL NEGOTIATIONS WERE CONTINUING OVER VARIOUS "TECHNICALITIES.") HERNANDEZ THOUGHT THAT THE SMALLER COMPANIES WERE BEGINNING TO COME AROUND. IN HIS VIEW THE GOV CALCULATED CORRECTLY IN CALCULATING FIRST-QUARTER PRICES AND MARKET CONDITIONS ARE BEGINNING TO PERSUADE THE COMPANIES OF THAT FACT. HE DID SAY THAT PETROVEN WOULD MAKE SOME ADJUSTMENTS DOWN-  
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WARD ON PRICES OF THE HEAVIER OILS AT THE BEGINNING OF THE SECOND

QUARTER. THE MINISTER EXPRESSED CONFIDENCE THAT VENEZUELA WOULD REACH ITS GOAL OF AN AVERAGE TWO MILLION B/D FOR THE CALENDAR YEAR.

4. HE COMMENTED AT THIS POINT THAT THE STRONG INITIAL RESISTANCE OF THE COMPANIES TO THE GOV'S PRICE SCHEDULE HAD SERVED A USEFUL PURPOSE. THIS CONFRONTATION AND THE PUBLIC ALARM IT PRODUCED HAD RENDERED RIDICULOUS THE CHARGES THAT THE NATIONALIZATION PROCESS WAS ALL PRE-COOKED BETWEEN THE GOV AND THE COMPANIES. ATTENTION HAD ALSO BEEN DIVERTED AWAY FROM THE SENSITIVE QUESTION OF THE TECHNICAL SERVICES CONTRACTS. HERNANDEZ ADDED, HOWEVER, THAT HE TOOK FULL PERSONAL RESPONSIBILITY FOR THE ARRANGEMENTS WITH THE COMPANIES AND WOULD BE READY TO DEFEND THEM PUBLICLY AS COMPLETELY HONEST AND IN THE BEST INTERESTS OF VENEZUELA.

5. I TOLD THE MINISTER THAT I CONTINUED TO BE CONCERNED THAT THE SMALLER COMPANIES RECEIVE JUST TREATMENT. I REFERRED TO TWO PARTICULAR PROBLEMS THAT HAVE BEEN BROUGHT TO OUR ATTENTION: THE CASH IN THE GUARANTY FUND; AND THE APPARENT REFUSAL OF THE MINISTRY OF FINANCE TO ALLOW EXPENSING OF UNAMORTIZED COSTS ASSOCIATED WITH RELINQUISHED CONCESSIONS DURING THE TAX YEAR IN WHICH THE RELINQUISHMENT OCCURRED. (COMMENT: ON THE LATTER POINT THE FINANCE MINISTRY HOLDS THAT SUCH COSTS SHOULD HAVE BEEN WRITTEN OFF PROGRESSIVELY AGAINST ONGOING OIL PRODUCTION. THIS IS CONTRARY TO WHAT AT LEAST ARCO CLAIMS WAS ITS UNDERSTANDING.)

6. HERNANDEZ ASSURED ME THAT THE COMPANIES WOULD BE ALLOWED TO RETRIEVE THEIR CASH FROM THE GUARANTY FUND AS PROMISED. HE SAID THE COUNCIL OF MINISTERS HAD APPROVED THE NECESSARY PROCEDURES ON FEBRUARY 3 AND THAT THE EXCHANGE OF COMPENSATION BONDS FOR CASH COULD BEGIN AS SOON AS THE PAPERWORK IS COMPLETE. THE MINISTER WAS LESS FORTHCOMING ON THE SECOND POINT. HE ASSERTED THAT THE COMPANIES HAD RECEIVED BAD TAX ADVICE ON WRITE-OFFS OF CONCESSION BONUSES AND EXPLORATION COSTS. HE ADDED, HOWEVER, THAT HE WOULD BE PREPARED TO DISCUSS PERSONALLY THIS AND OTHER PROBLEMS THAT MIGHT OCCUR WITH ANY COMPANY REPRESENTATIVES I WISHED TO REFER TO HIM. HE INSISTED THAT HE WANTED TO KEEP THE SMALLER COMPANIES HERE AS IN THE BEST INTERESTS OF VENEZUELA. HE ALSO NOTED, HOWEVER, THAT THEY WOULD HAVE TO TAKE THE "LONG VIEW" ON THE PRICE ISSUE.

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7. HERNANDEZ SAID THAT THE GOV IS ON THE POINT OF ANNOUNCING AN ACTIVE PROGRAM TO TEST THE POTENTIAL OF THE ORINOCO PETROLIFEROUS BELT. THE SCHEME AS HE DESCRIBED IT IS TO ESTABLISH FOUR PILOT PROJECTS, EACH TO BE INTEGRATED FROM DRILLING TO REFINING AND EACH DESIGNED TO PRODUCE PERHAPS 50 THOUSAND B/D. THESE WOULD ALL BE JOINT VENTURES, ONE WITH AMERICAN COMPANIES, ANOTHER WITH THE FRENCH, A THIRD WITH CANADIANS AND THE FOURTH WITH THE ROMANIANS.

EQUITY INVESTMENT WOULD BE REQUIRED FROM THE MINORITY PARTNERS. THE MINISTER CONCLUDED WITH THE STATEMENT THAT VENEZUELAN CALCULATIONS OF THE PUTATIVE PRODUCTION COSTS IN THE BELT WERE SURPRISINGLY LOW - IN THE FIVE TO SIX DOLLAR PER BARREL RANGE.

8. COMMENT: VALENTIN HERNANDEZ IS VIRTUALLY UNIQUE IN HIS GOVERNMENT AND AMONG HIS COUNTRYMEN IN ALMOST ALWAYS EXUDING SERENE CONFIDENCE. THE EXPERIENCE OF THE "CARLOS KIDNAPPING SEEMS TO HAVE ACCENTUATED THIS CHARACTERISTIC. AT THE MOMENT HE MAY HAVE REASON FOR OPTIMISM. PRODUCTION AND LIFTINGS ARE HIGHER THAN WXPECTED A MONTH AGO AND THE STRATEGY OF WAITING OUT THE COMPANIES SEEMS TO BE PAYING OFF. HE QUITE CLEARLY INTENDS TO CONTINUE THIS PATIENT COURSE, HOLDING FIRM ON PRICES AND HOPING THAT AT LEAST MOST OF THE COMPANIES WILL TAKE THE "LONG VIEW."

9. AS FOR THE ORINOCO BELT, WE CAN EXPECT A CONSIDERABLE POLITICAL STORM IF THE GOV DOES ANNOUNCE THAT IT IS GOING AHEAD TO UNLOCK THAT PURPORTED TREASURE HOUSE. IT WILL BE INTERESTING TO SEE HOW MUCH INTEREST THERE MIGHT BE AMONG THE COMPANIES IN PUTTING MORE MONEY INTO VENEZUELA.  
SHLAUDEMAN

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